UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

Hearing on
"Examining Proposals to Reform Insurance Regulation"

April 16, 2008

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On behalf of
The Self-Insurance Institute of America, Inc.

In support of House Bill
"Increasing Insurance Coverage Options for Consumers Act of 2008"

Mr. Chairman and Members of the Committee, my name is Lawrence Mirel. I am an attorney at the Washington law firm of Wiley Rein LLP. From 1999 to 2005 I served as the Commissioner of Insurance, Securities and Banking for the District of Columbia. As an active member of the National Association of Insurance Commissioners I participated in many heated discussions on the subject of today's hearing. I am delighted that the Subcommittee is taking an in-depth look at various proposals for insurance regulatory reform and honored to be invited to participate.

I am here today on behalf of the Self-Insurance Institute of America, Inc. ("SIIA") to testify in favor of a newly introduced bill known as the "Increasing Insurance Coverage Options for Consumers Act of 2008."

SIIA is the country's largest non-profit association that represents companies involved in the self-insurance/alternative risk transfer marketplace. Its membership includes self-insured employers, captive insurance companies, risk retention groups, insurance entities, captive managers, third party administrators and other industry service providers.

The Liability Risk Retention Act of 1986 ("LRRA"), which the new bill would amend, was enacted for the specific purpose of providing options to businesses and non-profit organizations that were having trouble finding commercial liability insurance that suited their specific needs at prices they could afford. The insurance crisis in the early 1980s featured liability insurance of all kinds, and especially professional malpractice insurance. Doctors and hospitals, in particular, were facing great difficulty in obtaining suitable coverage, as traditional insurers, faced with a huge increase in the number and size of medical malpractice lawsuits, were seeking to limit their exposure or were exiting the business entirely. Congress responded to the crisis by expanding the previous Product Liability Risk Retention Act of 1981 to allow risk retention groups to offer all kinds of liability insurance, not just product liability coverage.

Today, there is new insurance crisis. Because of the devastation caused by Hurricane Katrina and other major storms in 2005, commercial insurers are reevaluating their exposure in areas of concentrated catastrophic risk and in some cases are seeking to reduce their property insurance coverage in such areas. As a result, the cost of property insurance is rising everywhere and in some places is hard to obtain at any price. The problem is worse for commercial property than for private homes because some of the mechanisms created by states to ease the problem, such as the Texas wind pool and the Florida catastrophe fund, provide coverage only for residential properties. And despite Congressional action to provide a federal backstop for terrorism risk insurance, commercial property owners in certain “high risk” cities are also struggling with the cost of obtaining terrorism risk insurance in the traditional market.

This has led to a renewed interest in the possibilities offered by the alternative risk market, which includes all kinds of self-insurance mechanisms such as captive insurance and risk retention groups. These non-traditional insurance entities provide options that are not available through the commercial insurance market. Risk retention groups in particular provide a way for businesses and non-profit organizations that are engaged in similar kinds of activities and face similar risks to band together and collectively provide insurance coverage to their members. Currently these risk retention groups may only offer liability insurance to their members. The new bill would allow them to offer property insurance coverage as well.

I want to point out that the bill under consideration does not call for a government solution to the property insurance crisis. No new responsibilities would be undertaken by any agency of the federal or state governments and no taxpayer money would be put at risk. This bill would simply provide consumers with another competitive option to manage their risk exposure in a difficult environment where capacity is limited. It would empower commercial property owners in the private sector to come together to form risk retention groups that would provide property insurance protection to their members, in the same way that risk retention groups have been providing liability coverage for more than 20 years. As the Government Accountability Office (“GAO”) said in its 2005 report on risk retention groups under the LRRA, risk retention groups have had an "important effect on increasing the availability and affordability of commercial liability insurance for certain groups."

Over more than two decades the risk retention law has been a proven success. It did what it was supposed to do. It helped ease the problems caused by contractions in the traditional insurance market by providing incentives for organizations facing similar risks to band together to deal collectively with their insurance problems through a self-insurance mechanism, the risk retention group.

Even limited as they currently are to liability risks, risk retention groups still write more than $2.5 billion a year in coverage for their members. If the pending bill is enacted, and risk retention groups are able to offer commercial property insurance, we anticipate that in a few years the amount of insurance written by risk retention groups will more than double, providing much needed capacity to areas prone to catastrophic risk. While still a small proportion of the total amount of liability and property insurance written in the United States, a risk retention group offers a number of important incentives to its members:

- Policies can be written that more precisely fit the risks of the member entities. Risk retention groups offer their members "custom made" insurance plans instead of the "off the shelf" plans offered by commercial insurers.
- Underwriting can be geared to the actual risks of the member companies, instead of their risks being averaged with the risks of other kinds of entities that may in fact be very different. This more precise understanding of the risks that the members of a risk retention group are exposed, results in more precise and, in most cases, lower costs.
- A risk retention group allows more knowledgeable and professional risk management to take place, further reducing costs. A self insured hospital or group of hospitals can provide better management of its own risks than a commercial insurer can, if for

no other reason, than the realization that the money used to pay claims comes from the entities that are insured.

- Perhaps most important of all, the appeal of a risk retention group is that it can operate across state lines without having to be licensed in multiple jurisdictions and subject to overlapping regulatory authority. For an association of hospitals located in several different states, for example, or for an organization of churches that has facilities in every state and perhaps foreign jurisdictions as well, this ability to have a single regulator—the commissioner of insurance in the state of domicile—is a huge advantage, providing savings of money and time that can be better used to cover risk.

Insurance regulation is primarily designed to protect unsophisticated consumers of a complex product from being misled about what they are buying, or cheated when they try to collect under their policies for losses suffered. But risk retention groups, like other forms of self-insured entities, are the **providers** of their own insurance. They have designed their own policy, so they are not likely to be fooled about what is covered and what is not. When a loss occurs they are not likely to cheat themselves out of compensation. They are also not likely to overcharge themselves for their own insurance. For all of these reasons risk retention groups do not require the same regulatory scrutiny as commercial insurers that provide coverage to the general public.

Of course this assumes that risk retention groups are truly run by, and for, their members. The GAO report pointed out that sometimes risk retention groups are run by people from the outside who do not necessarily have the best interests of their members in mind. Therefore, the GAO recommended, and this bill provides, safeguards to make sure that risk retention groups are truly self-governing. The Self-Insurance Institute of America strongly endorses those provisions of the bill. By setting federal standards for the governance of risk retention groups the bill will provide uniformity and better consumer protection.

Most of the problems that risk retention groups have experienced have been the result of management that did not sufficiently appreciate and protect the interests of the member organizations that make up the group. This bill would both allow risk retention groups to offer a broader range of insurance coverages and would help ensure that they are truly run in the best interest of their members. It thus strikes the right balance of providing both opportunity and responsibility to those entities that use risk retention groups as a way of insuring themselves.

Risk retention groups have a single regulator for most purposes, and that regulator is a state official. It is important to point out that there is a real problem with the current way we regulate insurance in this country—and I say this as a former state insurance regulator: It is difficult to justify the expense and hassle that a multi-state insurance company has to go through to offer the same or similar products throughout the United States. This duplicative and overlapping review of the same products and the same services by 55 separate insurance commissioners makes little sense. There have been various proposals for regulatory reform, including bills that would establish a federal insurance regulator and others that would build on the LRRA model to allow for single state regulation. SIIA takes no position on which is preferable, but we are adamantly in support of the concept of a **single regulator** to replace the current inefficient and overlapping system under which insurers are subject to redundant regulatory supervision by more than 50 state insurance commissioners.

The history of the LRRA has demonstrated that a system that relies on a single regulator can be an effective and efficient model for regulatory reform. The Act provides that risk retention groups are regulated primarily by their domiciliary states, with only limited regulatory oversight by the states where the risk retention groups operate. The ability to operate across state lines, and even nationally, with a single primary regulator has been an important reason for the growth of risk retention groups. This concept has worked well for more than 20 years for those kinds of self-insurance entities that qualify as risk retention groups and for the limited kinds of insurance that they can offer. Given the success of these risk management vehicles, there is no reason not to expand coverage options to commercial property.

The U.S. risk retention system works very well, but it does not work perfectly. Although the LRRA provides that a licensed risk retention group is exempt from most state insurance laws other than the laws of its state of domicile, and most non-domestic state regulators honor that requirement, some do not. In a recent case, a risk retention group licensed and regulated by the Montana Insurance Commissioner was the subject of a "cease and desist" order issued by the California Insurance Department. The risk retention group was successful in obtaining a preliminary injunction against the California Department. The court recognized that the LRRA prohibited exactly the kind of "second guessing" by the non-domestic state regulator that the California Department was engaged in[1] and there have been other decisions upholding the preemption provisions of the LRRA.[2]

It is difficult, however, for risk retention groups to have to fight in court to uphold the law's preemption provisions when a state insurance commissioner decides not to abide by them. Therefore, we applaud the inclusion in this bill provisions that are designed to strengthen the preemption principle. These provisions will make it less likely that states will seek to thwart the clear intent of Congress by raising obstacles to non-domestic risk retention groups that operate across state lines. We are especially pleased that these provisions also include risk purchasing groups, because at least one court has drawn a distinction between risk retention groups and risk purchasing groups, holding that the preemption of regulatory authority by non-domestic regulators does not extend to the latter.[3]

[1] *Auto Dealers Risk Retention Group v. Poizner*, No. 07-cv-02660 (E.D. Calif. March 7, 2008).
[2] See *Nat'l Risk Retention Assoc. v Brown*, 927 F. Supp. 195 (M.D. La. 1996); *Attorneys' Liab. Assurance Soc'y, Inc. v. Fitzgerald*, 174 F. Supp. 2d 619 (W.D. Mich. 2001).
[3] *Fla. Dep't of Ins. v. Nat'l Amusement Purchasing Group, Inc.*, 905 F.2d 361 (11th Cir. 1990) (holding that risk *purchasing* groups, as opposed to risk retention groups, were not covered by the state preemption provisions of LRRA).

We applaud the subcommittee and especially the primary sponsors of this bill, Representatives Dennis Moore and Deborah Pryce, for recognizing the proven success of the Liability Risk Retention Act over more than two decades and for proposing to expand its scope to include commercial property insurance. Although the current crisis in the availability and affordability of commercial property insurance will not be solved by this bill alone, the expansion will allow property owners new options for coming together to deal collectively with their need to insure their property risks. This is a bipartisan bill and should not be considered controversial by anyone who understands and values the ability of people to come together to find market based solutions to common problems.

On behalf of the self-insurance community, thank you for letting me testify.